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Gambling with the Public Trust

**A Review of the Massachusetts State Lottery
Commission's Use of Free-Play and Discount Coupons**

**A Report of the
Senate Committee on Post Audit and Oversight
December 1997**

Massachusetts Senate
The Honorable Thomas F. Birmingham
Senate President

Senator Cheryl A. Jacques, Chair
Senator Robert A. Havern, Vice Chair
Senator Robert A. Durand
Senator Robert L. Hedlund
Senator Mark C. Montigny
Senator Marc R. Pacheco
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Senate Committee on Post Audit and Oversight

Senator Cheryl A. Jacques, Chair

The Senate Committee on Post Audit and Oversight works to ensure that state government is accountable to the citizens of the Commonwealth. The Committee's charge is to monitor compliance with federal and state laws, act as a watchdog to protect taxpayers from waste and fraud, evaluate the efficiency and effectiveness of state agencies and programs, and recommend corrective actions through legislation, regulation, or administrative initiatives.

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Executive Summary

The Massachusetts State Lottery Commission (MSLC), by issuing hundreds of millions of lottery coupons through a program operated without proper rules and regulations, gambled with the public trust.

The agency flagrantly circumvented the statutory cap on advertising expenditures and promotion by, in effect, cranking up a printing press of free-play and discount coupons that served as substitute currency for the MSLC. These coupons were explicitly traded with media outlets and businesses for millions of dollars worth of advertising. A give away program routinely distributed lottery coupons and free lottery season tickets to some organizations, while the vast majority of non-profit groups were unaware that such a give away program even existed.

The MSLC coupon program was out of control. In February 1997, the *Boston Globe* reported that the MSLC's Executive Director, Samuel M. DePhillippo, said that he was struggling to curb the lottery's "go-go" culture. The MSLC lottery coupon program epitomized that culture.

Who paid?

- The paying lottery player without equal access to free-play and discount coupons paid because lottery coupons diluted available prize money for these customers.
- The public paid because its trust in the Treasurer and MSLC administrators to run a professional lottery that is accountable to Massachusetts citizens was violated.

While this report is neutral regarding whether a lottery coupon program should exist in the future, it is abundantly clear that any future MSLC coupon program should be specifically authorized by the Legislature, fairly distributed, administered under an open process with written regulations, evaluated for effectiveness, accountable to the public, and sensitive to the nearly 200,000 Massachusetts residents struggling with gambling addiction.

After the *Boston Globe* published an investigative series on the Massachusetts State Lottery in February 1997, Senate President Thomas Birmingham directed the Senate Committee on Post Audit and Oversight to review the use of coupons by the Massachusetts State Lottery Commission.

Scope and Purpose of the Investigation

This report focuses on the following:

1. **The MSLC coupon program.** The report outlines the history and mechanics of the MSLC coupon program, including issues related to equity of distribution and accountability to the public. In addition, the Bureau sought to learn about other states' experiences with lottery coupon programs to highlight best practices.
2. **Circumvention of the statutory advertising cap.** The MSLC flagrantly disregarded the law; the report documents that circumvention in detail.
3. **Local Aid to Massachusetts cities and towns.** A May 1997 State Auditor's report identified a weakness in collecting accounts receivable at the MSLC. The Bureau explored the issue further because of its impact on local aid to Massachusetts cities and towns.
4. **Sensitivity to Residents Struggling with Gambling Addiction.** The report discusses the potentially negative impact of aggressive lottery promotion on addicted gamblers in Massachusetts.

The Legislature is currently considering a bill (House Bill 4656) that would reintroduce lottery coupons. While the MSLC has halted the use of lottery coupons for the time being, it is imperative to take a hard look at the MSLC coupon program because hundreds of millions of dollars in taxpayer resources have been used in this type of promotion. The MSLC should learn from prior mistakes made in administering the lottery coupon program and should avoid similar pitfalls in the future.

Coupon Program Rife with Problems

Circumvention of the Statutory Advertising Cap

Since 1994, the Legislature has made a concerted effort to rein in the promotional excesses of the MSLC. For example, the agency's FY 1996 line item clearly limited MSLC promotional activities:

For the promotional activities associated with the state lottery program; provided, that said promotional expenses shall be limited to point of sale promotions and agent newsletters; provided further that twenty-five percent of this appropriation shall be transferred from the State Lottery Fund to the General Fund quarterly.. \$400,000.

Every other budgetary line item associated with the MSLC currently includes strict prohibitions on advertising expenditures. Contrary to the intent and letter of the statute, the MSLC used coupons as part of an intentional strategy to circumvent the law.

Issues of Fairness

- Massachusetts residents did not have equal access to lottery coupons. Some towns never received Val-Pak bulk mailings, and distribution through coupons-for-advertising deals was uneven across regions.
- Through an unofficial give away program, the MSLC provided free-play coupons and free lottery season tickets to some organizations even though the vast majority of non-profit groups were unaware that such a program even existed.

Issues of Accountability

- The MSLC never promulgated regulations regarding how coupons were to be printed, distributed, or used. Consequently, the coupon program was administered in an arbitrary and unaccountable manner.
- Through coupons-for-advertising deals, some businesses received preferential treatment. In virtually all cases, no competitive bidding was required to participate in the program and no contracts were signed, although public resources worth millions of dollars were at stake. For example, one major Boston newspaper printed over 17 million coupons with a total value of more than \$7 million over a three-year period, while most media outlets received either a few thousand lottery coupons or none at all.
- The MSLC did not track prizes awarded to customers who used coupons to purchase lottery tickets, making it impossible to know the true cost of the promotion.
- The MSLC failed to protect the coupon program from misuse, abuse, and outright fraud. A 1996 investigation by the Attorney General's office uncovered serious criminal violations that resulted in several lottery agents and their employees being convicted of defrauding the Commonwealth. Prior to the Attorney General's sting operation, no lottery agent had ever had his or her license revoked for coupon abuse, according to documents provided by the MSLC. Moreover, despite public allegations of internal coupon misuse, the MSLC's Executive Director stated that no MSLC employee had ever been disciplined for abuse of lottery coupons. Furthermore, the MSLC failed to provide documentation to demonstrate that it has even investigated internal coupon abuse.
- Despite giving away hundreds of millions of coupons, the MSLC never evaluated the effectiveness of the promotion. Among the thousands of

documents reviewed by Bureau staff members, none indicate that the MSLC has ever independently evaluated the coupon program to see whether it worked to effectively promote the lottery and bring in new players.

Local Aid

- A State Auditor's report in May 1997 revealed that the MSLC was owed over \$13 million in accounts receivable in July 1996 from lottery agents who were delinquent in paying their debts.
- Given that the purpose of the MSLC is to provide property tax relief through the Local Aid Fund, Massachusetts cities and towns are inadequately represented on the Commission.

Gambling Addiction

- Massachusetts has not adequately researched compulsive and problem gambling associated with the state lottery, and gambling addiction experts report that little is known about the potentially negative impact of lottery advertising and promotional programs.
- Until the current fiscal year, Massachusetts had not committed adequate resources for outreach and treatment of compulsive and problem gambling.
- According to gambling addiction experts, promotions such as the direct mail coupon brochures have the potential to trigger a relapse for people struggling with gambling addictions. In the past, nothing was done to mitigate the potential damage done by direct mail promotions to the estimated 200,000 addicted gamblers in Massachusetts.

Recommendations

This report takes no position on whether a MSLC coupon program should exist. Over the next several months, the Legislature may debate legislation which seeks to reinstate the lottery coupon program. The purpose of this report is to outline past problems and make recommendations that should be followed if coupons are reintroduced as a vehicle to promote the state lottery.

Circumvention of the Statutory Advertising Cap

- For several years, the Legislature has been clear in its desire to limit the promotional excesses of the MSLC. The MSLC must abide by both the letter and spirit of the law and should seek specific legislative authorization for any program that would exceed statutory limits on promotional activities.

Issues of Fairness

- If a coupon program is reintroduced, the program must be structured in a way to provide all Massachusetts residents, businesses, and non-profit groups equal access to this taxpayer resource.
- If the MSLC reintroduces a give away program, access should be open to all non-profit groups: public notice and fair rules for distribution should be standard practice.

Issues of Accountability

- Rules and regulations must be promulgated prior to reinstating any coupon program. In California, for example, the state lottery has a general regulation for coupon programs and then promulgates individual regulations for each coupon promotion.
- Selection of partners for coupons-for-advertising deals should follow clear regulations. These regulations must include public notice, competitive bidding, and signed contracts as standard operating procedure. Coupons are a valuable taxpayer resource and should not be distributed in an arbitrary manner.
- There must be strict accountability regarding the true costs of coupon promotions. The MSLC must be able to report the prizes won by customers with coupons so that the agency can make a careful calculation of actual promotional costs.
- Security and enforcement procedures for coupon use and distribution must be strong. For example, after every coupon promotion, security personnel should review redemption statistics for possible abuses. It should be impossible to redeem a lottery coupon without purchasing a corresponding lottery ticket. Documentation that coupons were used in the ways intended must be maintained and available for review. Moreover, the MSLC should operate an aggressive enforcement program aimed at policing fraud by MSLC employees and lottery agents.
- The MSLC should undertake a thorough evaluation of the effectiveness of

any coupon program if such a program is reintroduced. The MSLC should follow the model of the California Lottery and evaluate each coupon promotion for effectiveness.

Local Aid

- The MSLC should explore additional sanctions to ensure that collections are timely and this important source of public revenue is not hindered. One proposal may be to preclude a lottery agent from receiving his or her bonus if a winning ticket is sold at their location and they have debts to the MSLC more than 30 days old.
- Given its mission to provide local aid to cities and towns, the MSLC should be expanded to include two representatives from the Massachusetts Municipal Association.

Gambling Addiction

- A broad review of gambling addiction associated with the Massachusetts State Lottery, including an analysis of the impact of lottery promotion and advertising on compulsive and problem gamblers, should be commissioned.
- At a minimum, the current level of funding for the Massachusetts Council on Compulsive Gambling should be maintained.
- If direct mail coupons are reintroduced, brochures should include a prominently-placed informational panel on the Massachusetts Council on Compulsive Gambling, including its toll-free telephone number.

Background

The Massachusetts State Lottery Commission (MSLC) operates under M.G.L. c.10, §§22-35, known as the State Lottery Law. The MSLC consists of the State Treasurer, the Secretary of Public Safety or her designee, the State Comptroller or his designee, and two persons to be appointed by the Governor. By law, the State Treasurer is the chairman of the MSLC.

The MSLC is authorized to conduct a state lottery and to determine the types of lottery or lotteries to be conducted, the prices of tickets in the lottery, and other details of the operation. The Commission is also empowered to establish or revise such rules and regulations as it deems necessary or desirable.

The State Treasurer, subject to the approval of the governor, is empowered to appoint a director of the state lottery who supervises and administers the operation of the lottery in accordance with the provisions of the State Lottery Law and the appropriate rules and regulations. The director, subject to the approval of the MSLC and the applicable laws relating to public contracts, "shall enter into contracts for the operation of the lottery, or any part thereof, and into contracts for the promotion of the lottery." M.G.L. c.10, §26.

Under M.G.L. c.10, §35, a State Lottery Fund was established in order to "provide local property tax relief and continue services at the local level." According to the law, revenues of the MSLC shall be expended only for the following purposes:

- (a) The payment of prizes to the holders of winning lottery tickets;
- (b) The expenses of the MSLC in administering and operating the lottery;
- (c) The purposes of the Local Aid Fund.

The Local Aid Fund was created by M.G.L. c.29, §2C 1/2. The fund captures state revenue from various sources, such as income taxes, excise taxes, and the state lottery, and directs money to cities and towns to reduce property taxes. One subsection of the law states that the Local Aid Fund will include "the balance of the State Lottery Fund after the payment of prizes and deductions for the expenses of administering and operating the lottery, as determined by the comptroller." M.G.L. c.29, §2C 1/2 (e).

In FY 1989, with Massachusetts in a recession, the Legislature placed a cap on the amount of funding provided to cities and towns through the Local Aid Fund. Acts of 1989, c.164. However, beginning in FY 1995, the Legislature began to phase out this local aid cap. Acts of 1994, c.60, §3.

According to Professor Richard McGowan, author of the book *State Lotteries and Legalized Gambling*, "the primary goal of a lottery is to be a *consistent* source of revenue for state government."¹ By that standard, the Massachusetts State Lottery has enjoyed success. In FY 1997, the lottery generated more than \$3.2 billion in gross revenues.² However, the more important figure is the net revenue to the Commonwealth. By that standard, as well, the Massachusetts State Lottery has done well. Annual profits have more than doubled in the past 12 years, from just over \$300 million in FY 1985 to \$720 million in FY 1997.³

The Negative Side of Lottery Growth

The growth of the Massachusetts State Lottery has not come without costs. The *Boston Globe* investigative series published in February 1997 exposed the underside of the MSLC's explosive growth and described an agency with a variety of serious operational flaws - most tied to its relentless push to expand.

There is one lottery sales agent for every 737 people in Massachusetts. The \$505 wagered annually per capita in Massachusetts is over twice the per capita spending per year on lottery products in Georgia, the next highest state for per capita lottery sales.⁴

Throughout the 1980's and early 1990's, the MSLC ran aggressive advertising campaigns aimed at getting more residents to buy lottery products. In FY 1994, under the leadership of Senate President Thomas Birmingham, then-Senate Ways and Means Chairman, the Legislature began to put the brakes on the MSLC's aggressive advertising campaigns. The statutory advertising cap was designed to maintain public awareness of the lottery but limit over-aggressive promotion to vulnerable residents.

After spending \$11.6 million on advertising in FY 1993, the MSLC's advertising budget was reduced to \$3.6 million in FY 1994, to \$2.8 million in FY 1995, and has since been capped at \$400,000. Since FY 1996, the scope of promotions has been explicitly limited to point of sale promotions and agent newsletters.

The *Boston Globe* investigative series exposed a glaring circumvention of the statutory advertising cap. Various types of coupon promotions played a prominent role in the strategy to circumvent the law. In addition, advertising costs were shifted to the prize, consultant, and professional services budgets.

After publication of the investigative series, the Senate President directed the

¹ Richard McGowan, "Lottery Games & Various Strategies for Conducting Lotteries," research report conducted on behalf of Massachusetts State Lottery Commission, undated.

² *Boston Globe*, September 27, 1997, p. C5.

³ MSLC, Press Release, October 19, 1997.

⁴ *Boston Globe*, February 9, 1997, p. A1.

Senate Committee on Post Audit and Oversight to conduct an investigation into coupon usage and other related policies of the MSLC.

The Senate Committee on Post Audit and Oversight is authorized under M.G.L. c.3, §63 to oversee the development and implementation of legislative auditing programs to be conducted by the Senate Post Audit and Oversight Bureau.

In addition to its direct investigative role, the Committee also receives reports from the State Auditor and other legislative auditors and is charged with determining what remedial measures, if any, are necessary. The Committee reports from time to time to the Legislature with recommendations for legislative action based either on the State Auditor's reports or on the recommendation of Bureau auditors.

Description of the MSLC Coupon Program

This section outlines the three primary ways that the MSLC distributed coupons and explores the problems that developed within each type of coupon promotion:

1. Direct Mail Coupons
2. Coupons-for-Advertising Deals
3. Give Away Program

Direct Mail Coupons

Direct mail coupons sent out via companies such as Val-Pak and Souper Coups are the best known and constitute by far the largest component of the MSLC coupon program.

Direct mail coupons were typically presented as several coupons in a brochure format valid for either free lottery tickets or buy-one-get-one-free offers for lottery products. The total value of the direct mail coupons was enormous: Bureau research estimates that Val Pak distributed coupons with a total value of approximately \$365 million from January 1994 through December 1996.⁵

Generally, the coupons were sent to Massachusetts residents in direct mail envelopes stuffed with coupons for various other services and products. Most of the MSLC's direct mail business was done with Val-Pak, but several mailings were also done through Souper Coups. The direct mail program with Val-Pak began in 1987 under the administration of Treasurer Robert Crane.⁶

Positive Developments with Direct Mail Coupons

In the 1990's, there were three major improvements in the direct mail coupon program: bar coding; the elimination of free coupons in favor of buy-one-get-one-free coupons; and increased site security at locations such as the Val-Pak distribution center in the state of Florida.

- Bar codes became part of Val-Pak security measures in September 1991.⁷ The bar codes are different from coupon to coupon and from brochure to brochure. The individual bar codes gave the MSLC the potential to track where and when coupons were redeemed. According to Val-Pak of

⁵ Fax from Catherine McGrath, Major Account Executive, Val-Pak of Massachusetts, February 26, 1997. The estimated total figure used Val-Pak distribution numbers and an actual count of the face value of lottery coupons in Val-Pak brochures provided to the Bureau by the MSLC.

⁶ Charles T. Clotfelter and Philip J. Cook, *Selling Hope: State Lotteries in America*, Harvard University Press: Cambridge, 1989, p. 175.

⁷ MSLC, John P. Kelly, Jr., Manager for Security, Memo to File, March 31, 1997.

Massachusetts, the MSLC was the first state lottery to use a bar code system.⁸

- Starting in January 1996, the MSLC started mailing buy-one-get-one-free coupons instead of coupons for free products. In previous years, all Val-Pak coupons had offered free lottery tickets. According to Jim O'Brien, Director of Marketing for the MSLC, the change was "an attempt to enhance the profitability of the mailing programs."⁹ With one exception, Val-Pak coupons have been of the buy-one-get-one-free variety since that decision.¹⁰
- After reports about possible high volume theft of lottery coupons, the MSLC undertook efforts to tighten security at distribution points such as the Spencer Press facility in Maine, the Val-Pak facility in Florida, and the Ditler Brothers plant in Georgia. In addition, MSLC personnel worked with Val-Pak and U.S. Postal Inspectors to identify the source of high volume redemptions in Western Massachusetts.

By all accounts, the Val-Pak program was popular with most households. For example, almost one-half of Val-Pak lottery coupons distributed were redeemed, an extraordinarily high percentage for direct mail coupons. An informal survey done by Val-Pak of Massachusetts in July 1996 reported that over 98 percent of respondents wanted to continue to receive lottery coupons.¹¹ However, the sample may have been skewed since Val-Pak offered a sweepstakes prize of 5,000 free-play lottery coupons to individuals who responded to the survey.¹²

Issues with the Val-Pak and Other Direct Mail Coupons

1. Val-Pak mailings do not reach all of the state's households. Currently, there are 2,356,548 households in the state, and Val-Pak of Massachusetts reaches 2,220,000 of them, approximately 94 percent.¹³ Some towns – such as Athol, Hubbardston, and Ashburnham – do not receive bulk Val-Pak coupons, while most other areas of the state have literally received hundreds of millions of coupons over the past 10 years.¹⁴

⁸ Catherine McGrath, Major Account Executive, Val-Pak of Massachusetts, Correspondence with Treasurer Joseph Malone, February 17, 1997.

⁹ Massachusetts State Lottery Commission meeting, minutes, December 11, 1995.

¹⁰ The Drive of a Lifetime promotion with Chevy Dealers of New England used free-play coupons as part of the promotion.

¹¹ Catherine McGrath, Major Account Executive, Val-Pak of Massachusetts, Correspondence with Treasurer Joseph Malone, February 17, 1997.

¹² Catherine McGrath, Major Account Executive, Val-Pak of Massachusetts, Correspondence with Senate Post Audit and Oversight Bureau, December 1, 1997.

¹³ *Ibid.*

¹⁴ Throughout its mailings in 1995 and 1996, the MSLC typically took part in Val-Pak mailings for 2.1 million homes. There is a mechanism, called the Merge/Purge Program that will allow Val-Pak to reach 100 percent of homes in Massachusetts, but the cost is significantly higher to the MSLC. While bulk mailing through Val-Pak of Massachusetts generally costs 2.5¢ per home, Merge/Purge or Solo mailing costs 25¢ per home. At some point in

2. Even though bar coding went into effect in 1991, there is no evidence that the MSLC used its ability to track coupon redemption to effectively protect the program from abuse and fraud before 1996. Until the Massachusetts Attorney General's office launched criminal investigations, the MSLC had not disciplined one lottery agent for coupon abuse and did not have strict enforcement mechanisms.¹⁵
3. Val-Pak coupons were often used for purposes other than direct mail to Massachusetts residents. According to Val-Pak of Massachusetts, approximately \$1 to \$2 million worth of Val-Pak over-run coupons were returned to the MSLC.¹⁶ So many coupons were printed that the coupons became a form of substitute currency for the MSLC: for example, Val-Pak coupons were used to settle accounts with lottery agents, pacify dissatisfied lottery customers¹⁷ and in a give away program to organizations.¹⁸
4. Once the MSLC no longer had the advertising budget to pay for distribution of Val-Pak coupon brochures, coupons-for-advertising deals were struck to pay for the \$62,000 cost of statewide distribution. Generally, businesses which agreed to pay the distribution costs were paid with tens of thousands of coupons and prominent placement on the MSLC Val-Pak brochure. With one exception, there was no competitive bidding or written contract, even though the MSLC was trading public resources worth tens of thousands of dollars.
5. Since Val-Pak mailings were distributed indiscriminately to approximately 94 percent of households in Massachusetts, the MSLC invariably sent coupons to people grappling with a compulsive gambling addiction.
6. Despite public allegations that MSLC personnel used lottery coupons for such things as paying for a Christmas party and "tipping" police officers,¹⁹ the MSLC's Executive Director stated that no employee had ever been disciplined for misuse of coupons. In fact, the MSLC failed to provide documentation that any employee had even been *investigated* for potential abuse of coupons.

the past, the MSLC has mailed to towns through Solo mailings.

¹⁵ MSLC, Memo from John P. Kelly, Jr., Manager of Security, to File, Coupons: Chronological Sequence of Events, March 31, 1997. Also, MSLC, Memo from Jay Harney, Associate Legal Counsel, to Sam DePhillipo, Executive Director, Regarding Val-Pak Sting Operation, December 9, 1996. Together, these memos cover the history of coupon enforcement through the decade of the 1990's.

¹⁶ Catherine McGrath, Major Account Executive, Val-Pak of Massachusetts, Correspondence to Treasurer Joseph Malone, February 17, 1997. The letter states that the MSLC received over-runs equal to 1 to 2 percent of total Val-Pak production. Val-Pak brochures contained between \$107 and \$129 million in lottery coupons annually.

¹⁷ MSLC, Memo from John P. Kelly, Manager of Security, to David Railsback, Coupon Controls, February 7, 1997.

¹⁸ MSLC, Correspondence from Paula Morris, Public Relations Manager, to Bank of Braintree, September 13, 1996.

¹⁹ *Boston Globe*, February 10, 1997, p. A1.

Off to the Races with Val-Pak

In exchange for paying part of the cost to distribute a Val-Pak mailing during the spring of 1996, the Raynham Taunton Greyhound Park received advertising on three panels of the MSLC Val-Pak brochure. In addition, the MSLC provided up to \$70,000 in free bet coupons to the greyhound park -- drawings were held four times daily for 100 free lottery coupons, and once for a grand prize of \$25,000 in free lottery coupons.²⁰ Based on the documentation provided by the MSLC, no other greyhound parks were offered a similar promotion, and there was no competitive bidding done prior to organizing the joint promotion.

Coupons-for-Advertising Deals

While there is some history of coupons-for-advertising deals before the advertising cap became law,²¹ the MSLC explicitly and exponentially expanded coupons-for-advertising deals in recent years to deliberately circumvent the statutory cap on advertising. A marketing report from a December 11, 1995 meeting of the MSLC stated that "currently our advertising efforts are aimed at developing Cooperative Programs with radio stations, newspapers and consumer marketers."²²

To support these coupons-for-advertising deals, the MSLC essentially cranked up a printing press of free-play and discount lottery coupons to "purchase" promotional services in exchange for millions of dollars worth of lottery coupons. The MSLC, a state agency, created this substitute currency despite a clear legal mandate to cap its advertising expenditures at \$400,000 annually and a prohibition on all promotion except for in-store displays and agent newsletters. Finally, the printing press for lottery coupons was cranked up in an unaccountable manner – without specific statutory authorization, official regulations, or proper documentation.

The following pages provide several sample letters and invoices that demonstrate explicit trading of coupons for advertising:

- An invoice from WNNZ Radio in Springfield for \$6,000 in advertising time in exchange for \$5,000 in free bet coupons for The Big Game.
- A memo from WSAR Radio in Fall River that states, "As we discussed, in

²⁰ MSLC, Val-Pak Brochure, March 1996.

²¹ *Public Gaming*, "Instant Games: Another Successful Experiment for Massachusetts," Volume 13 (October 1985).

²² Massachusetts State Lottery Commission, minutes, December 11, 1995.

exchange for \$500 in \$5.00 lottery coupons, WSAR will provide (50) :10 promotional announcements for the Massachusetts State Lottery."

- A memo from WMJX Radio in Boston that states, "In exchange for 500 \$1.00 lottery coupons, the Massachusetts State Lottery will receive... \$4,000 worth of advertising on WMJX radio over a two week period in July or August.."
- A memo from Louis & Company on behalf of the Eastman Kodak Company that summarizes the discussion between Kodak Royal Paper dealers and the MSLC; Kodak will provide \$40,000 in promotional costs, including \$32,000 for newspaper and radio advertising, in exchange for 40,000 free-play coupons valued at \$1.00 each.

Coupons as Currency

The coupons-for-advertising deals traded millions of coupons for millions of dollars worth of advertising. The coupon program was used by the MSLC to entice companies to sponsor the distribution of Val-Pak coupon brochures.

New England Development, which operates 13 malls in New England, received \$187,500 in free-play coupons to promote its shopping malls during the 1996 Christmas buying season.²³ In exchange, New England Development paid for the distribution of MSLC Val-Pak coupons and included the Massachusetts State Lottery in its seasonal advertising.

The MSLC organized a promotional tie-in with Chevy Dealers of New England. This is one of the only coupons-for-advertising deals that involved competitive bidding and a written contract. The MSLC agreed to purchase 30 Chevy Blazers for use as prizes, print 75 million instant tickets entitled "Drive of a Lifetime," support the promotion via Bonus Bonanza, and promote Chevy Blazers in other ways. The Chevy Dealers of New England agreed to launch a major radio, newspaper, and television campaign worth approximately \$750,000 on behalf of the joint promotion, as well as to pay for the distribution cost of two Val-Pak mailings for the MSLC. To sweeten the deal for the Chevy Dealers of New England, the MSLC agreed to provide \$200,000 in free-play coupons to be given to individuals who test drove a new car and another \$50,000 in free-play coupons via a sweepstakes.²⁴

The above examples represent only a small number of the MSLC's deals involving coupons as currency.

²³ MSLC, Memo on Coop Promotions in 1996, undated.

²⁴ MSLC, Roger Peterson, Advertising Director, Correspondence to John Cuneo, Cuneo, Sullivan, Dolabany, February 20, 1996.

WNNZ

THE TALK STATION
AM 640

AGREEMENT BETWEEN WNNZ RADIO AND THE FOLLOWING
ADVERTISING AGENCY, MEDIA BUYING SERVICE, OR ADVERTISER

Mass. State Lottery
60 Columbian Street
Braintree, MA 02184

Phone Number Rob Ackman: (617) 841-5639

Product The Big Game

log as: Big Game Promo

SCHEDULE AND RATES

FACILITIES ORDERED & DATES	LGTH	APPROXIMATE TIME	DAYS-SCHEDULES							NO. UNITS	CHARGES	
			M	T	W	T	F	S	S		UNIT	TOTAL
11/11 12/13	10	5:30a - 9a	3	3	3	3	3					
		9a - Noon	3	3	3	3	3					
		Noon - 3p	3	3	3	3	3					
		3 - 7p	3	3	3	3	3					

COUPONS
SENT BY
FEDERAL
EXPRESS
TO
STATION

TOTAL \$ UNITS WEEKLY 300 TOTAL CHARGES WEEKLY barter TOTAL

ADDITIONAL INSTRUCTIONS BARTER: \$6000 in exchange for \$5000 of free bet coupons for The Big Game.

Contests air every weekday in morning drive 5 - 9am for 5 weeks, plus grand prize contests in week #6.

(phone) Rob Ackman
Accepted for Advertiser

Curt
Accepted for 640 WNNZ
Celia Communications, Inc

Start Date 11/11/96 Account Executive chh
End Date 12/13/96 Time Advertiser OK
Number of Weeks 5 Copy Advertiser
Today's Date 11/8/96 Spot Length
Sponsor Number Term X 1

This Agreement is between the client named and WNNZ and is for broadcast advertising. Interest of 1.5% per month is charged on balances unpaid after 10 days. Advertiser will pay all collection costs and attorney's fees if attorney is employed to enforce payment. All Sales subject to short rate.

1500 Main Street • P.O. Box 15640 • Springfield, MA 01115-5640 • (413) 735-6400 • Fax: (413) 858-1958

A Service of Celia Communications, Inc

Insert A



BRISTOL COUNTY'S
BEST RADIO
NEWS/TALK/SPORTS



FAX - (617) 849-5589

TO: Roger Peterson, Advertising Manager
Massachusetts State Lottery

FROM: Carole W. Fiola, General Manager
WSAR/WHTB

A handwritten signature in cursive script, appearing to read "Carole W. Fiola".

DATE: February 23, 1996

Thank you for agreeing to trade lottery tickets for promotional participation in our grand opening activities for Rizzo Ford in Fall River. The event will take place March 11-16, 1996.

As we discussed, in exchange for \$500.00 in \$5.00 lottery coupons, WSAR will provide (50) :10 promotional announcements for the Massachusetts State Lottery. You will provide copy for the promos and it will be aired in conjunction with the Grand Opening Promotion.

Thanks again for your help Roger. We look forward to working with you again soon.

Carole W. Fiola
General Manager

MEMORANDUM

_____, Massachusetts State Lottery
_____, WMJX
_____, Community

_____ an advertising campaign for Parrelli Optical
(seven MA locations).

Parrelli Optical, along with Magic 106.7 would like to team up with the
Mass. State Lottery for a two-week trial advertising campaign to air this
July or August.

In exchange for 500 \$1.00 lottery coupons, the Mass. State Lottery will
receive feature (minimum of 10 seconds) in \$4,000 worth of advertising on
WMJX radio over a two week period in July or August.

Roger, I welcome your calls should you have any questions or ideas.

If possible, a reply is requested by June 7th.

Many thanks!!!

Agreed By: _____
For: _____
Date: _____

LOUIS & COMPANY

222 Forbes Road • Suite 204 • Braintree, MA 02184 • (617) 356-5830 • FAX (617) 356-0735

May 23, 1995

To: Roger Peterson
Advertising Manager
Massachusetts State Lottery

From: Lou Trubiano

Re: Kodak Royal Paper Promotion

Copies: Tony Paxton
Eastman Kodak Company
Peter Morton
Knight Quality Stations

Here is a summary of how we propose to implement the summer promotion we have discussed involving the Lottery with Kodak Royal Paper dealers throughout Massachusetts.

How It Will Work:

There will be 90 to 110 retail locations involved in the promotion which has a theme of "YOUR PICTURES COULD BE WORTH A MILLION DOLLARS" on Royal Paper this summer. During the promotion, consumers bringing in film for processing will receive a "scratch and win" ticket in their envelope when they pickup their prints. Every ticket will be a winner, with the featured prizes being "free plays" from the Lottery. Other prizes will be provided by Kodak and include discounts on photofinishing and Kodak products.

The promotion will kickoff late July and run for three weeks. Advertising support will run for two weeks. The number of "scratch and win" tickets produced and disseminated will range from 125,000 to 150,000.

Kodak Will Provide:

Kodak will put a budget of \$40,000 behind the promotion as follows:

Production of Scratch and Win Tickets	\$ 5000.00
Production of POS Materials (100 stores)	\$ 1000.00
Production of Print Ads and Radio Spots	\$ 2000.00
Newspaper and Radio Advertising	<u>\$32000.00</u>
TOTAL	\$40000.00

Advertising dollars will be allocated according to the number of Royal Paper dealers in the region. A detailed breakout of the proposed media buy is attached.

In addition to the advertising schedule outlined, participating dealers will be receiving ad slicks and radio scripts for use in their immediate markets to increase local exposure of the promotion. This is in addition to the Point-of-Sale displays calling out the promotion which will be in place in all participating stores for three weeks.

Combined circulation of the newspapers involved is close to 700,000. The Lottery will be prominently included in all print advertising. With the major vehicle being a full page (broadsheet) color ad in the Sunday Boston Herald, the Lottery will be offered significant space for its own message. In addition to calling out the Lottery promotion, print ads will also have a photofinishing discount coupon valid at all participating stores.

Print will be supported with radio advertising in the Boston, Worcester and Cape Cod markets.

The Lottery Will Provide:

The Lottery is expected to support the promotion with 40,000 "Free Plays" valued at \$1.00 each. In addition, the Lottery will fulfill the requests from holders of winning tickets who will be required to mail them to the Lottery to receive their free bet slips.

This summarizes the major elements of the proposed promotion. Kodak Royal Paper dealers have indicated strong support for the program, and Kodak is ready to put everything into motion pending final approval from the Lottery.

In 1996, there were over 40 similar coupons-for-advertising deals -- ranging from large corporations such as Schweppes, to tiny publications like *FYI* in Tewksbury. In every case, coupons were traded for advertising.

Issues with the Coupons-for-Advertising Deals

1. The coupons-for-advertising deals that were entered into after the statutory advertising cap went into effect were clearly designed to and had the effect of circumventing the strict language of the law. Documents included in this section clearly detail the explicit trading of coupons for advertising.
2. The MSLC consistently failed to solicit coupons-for-advertising deals in a fair or equitable manner. There was no competitive bidding process to ensure that taxpayers were getting the best possible deal. One major Boston newspaper printed more than 17 million coupons over a three-year period while other media outlets received a few thousand lottery coupons or none at all. As a result, residents in areas where newspapers or radio stations did not enjoy working relationships with the MSLC were denied equal access to lottery coupons.
3. Even though millions of lottery coupons were traded through coupons-for-advertising deals, there was no system to ensure that the coupons were used as intended.

A "Special Relationship" with the Boston Herald

The *Boston Herald* has acknowledged that it enjoyed a "special, although not unique, relationship with the Massachusetts State Lottery."²⁵ During calendar years 1994 through 1996, the *Boston Herald* printed more than 17 million coupons in the newspaper, with a total value of more than \$7 million. These *Boston Herald* lottery coupons were immediately redeemable for discounts on lottery products. Other newspapers were limited to mail-in offers, such as mail-in sweepstakes contests, which MSLC personnel described as "not as strong a consumer promotion."²⁶ In comparison, no other newspaper received more than 50,000 lottery coupons, according to a MSLC memo describing coupons-for-advertising deals in 1996 and early 1997.²⁷ Joint promotions with radio stations typically involved fewer than 5,000 lottery coupons.²⁸

Moreover, the decision to allow the *Boston Herald* to print lottery coupons directly in their newspaper appears to have been based on informal reasons, rather than on professional marketing research.²⁹ One MSLC memo from Jim O'Brien, Director of Marketing, expressed qualms about printing discount lottery coupons directly in the newspaper and argued instead for a larger sweepstakes: "This would still provide the Herald a strong point of differentiation from their competitors and would provide consumers with significant incentive to purchase the paper."³⁰

²⁵ *Boston Herald*, February 24, 1997, p. 18.

²⁶ MSLC, Memo from Jim O'Brien, Director of Marketing, to Eric Turner, Executive Director, Herald Promotion, undated.

²⁷ MSLC, Coop Promotions in 1996.

²⁸ *Ibid.*

²⁹ There are a number of documents that point to this conclusion, including the following: Telephone message Office of Pat Purcell to Treasurer Joseph Malone, March 25, 1994. MSLC, Memo from Jim O'Brien, Director of Marketing, to Eric Turner, Executive Director, Herald Promotion, undated. *Boston Herald*, Correspondence from Gwen Gage, *Boston Herald* Vice President of Promotion, to Roger Peterson, MSLC Director of Advertising, December 28, 1994. Telephone Message from Barbara in *Boston Herald's* publisher's office to Treasurer Joseph Malone, March 22, 1995. *Boston Herald*, Correspondence from Gwen Gage, *Boston Herald* Vice President for Promotion, to Roger Peterson, MSLC Director of Advertising, May 30, 1995.

³⁰ MSLC, Memo from Jim O'Brien, Director of Marketing, to Eric Turner, Executive Director, Herald Promotion, undated. The memo was written prior to April 1994 since it refers to an upcoming promotion in the *Boston Herald* beginning on April 18, 1994.

The MSLC Give Away Program

In addition to using coupons for direct mail promotions and coupons-for-advertising deals, the MSLC gave away thousands of lottery coupons to select organizations. Tens of thousands of dollars worth of lottery coupons or free season tickets were given away by the MSLC over several years. While most of the organizations appear to be legitimate non-profit groups, in at least one instance, the MSLC simply gave away coupons to the world's largest food company to be used at trade association conventions.

According to Bureau research, it is rare for state lotteries to give away coupons to organizations. Only three states -- Delaware, Iowa, and Montana -- reported giving lottery coupons directly to charities in a survey conducted by the Senate Post Audit and Oversight Bureau.³¹

Nestling Up To Nestlé

The MSLC had a special relationship with the Nestlé Corporation. The company received \$28,100 worth of lottery coupons over a three-year period that were to be used to support promotions at various retailer locations, trade shows, and state-wide events.³² On at least one occasion, a Nestlé regional business manager requested free-play coupons to provide as raffle prizes at upcoming trade association conventions. Despite the fact that over \$28,000 in a taxpayer resource was given to a private corporation, there was minimal documentation that the lottery coupons were used to the benefit of the public.

Issues with Give Away Coupons

1. The MSLC give away program never operated under formal regulations.
2. All organizations did not have equal access to the MSLC's give away program. The MSLC and the Treasurer dispersed public resources - not personal ones - and therefore the give away program was not operated in a fair manner.
3. Record keeping for the give away program was inadequate. The MSLC could not even provide a list of recipients before 1995.
4. There is no evidence that the agency tried to track whether the coupons handed out to organizations were used in the ways intended.

³¹ Senate Post Audit and Oversight Bureau, Internal State Lottery Survey, Summer 1997.

³² MSLC, Coop Promotions in 1996, undated.

2 ADAMS PLACE
QUINCY, MA 02169-7456
TEL (617) 356-4000
FAX (617) 356-4814

000178

May 14, 1996

Mr. Roger Peterson
Massachusetts State Lottery
60 Columbian Street
Braintree, MA 02184

1203
CO-280-75

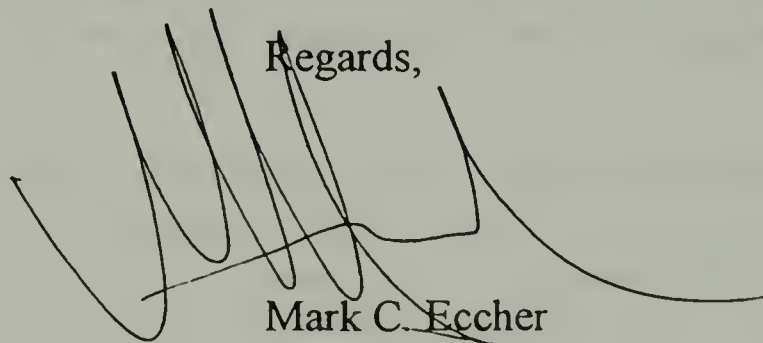
Re: Tickets

Dear Roger:

I have been asked by the MFA and NEWFDA to donate raffle prizes for our upcoming conventions. Could you please arrange for us to raffle two books of \$1.00 and one book of \$2.00 tickets? In exchange, we will participate in the Baby Ruth ("This Baby Gets You Going") giveaway for the Lottery.

Thank you for your help.

Regards,



Mark C. Eccher

Coupons in Context

Ironically, while the MSLC placed coupons at the heart of its promotional plan, the corporate world began to doubt the efficacy of coupons as a promotional strategy. For example, according to an article in the *Harvard Business Review* in 1990, 84 percent of trade promotions are not profitable; for most companies, the cost of an extra \$1.00 of sales is greater than the \$1.00 spent to achieve the sales increase.³³ The reason is that the manufacturer has to sell an extraordinarily high volume of product at the discounted price to cover the normal base sales that would have taken place without the promotion. Also, the *Harvard Business Review* states that consumers are likely to "forward purchase," i.e., buy lottery tickets now with the coupon rather than buy them later without a coupon.

The Most Efficient Lottery in the United States?

Treasurer Joseph Malone and MSLC personnel trumpet the Massachusetts State Lottery as the most efficient in the United States.³⁴ According to the MSLC, administrative expenses were just 2.2 percent of sales in FY 1997. However, the Committee's examination of the MSLC's coupon program indicates that tens of millions of dollars in advertising and promotional expenses were hidden because the MSLC printed tens of millions of coupons annually, traded coupons for advertising, and shifted the vast amount of its promotional costs to its prize budget. Comparing expenses at the MSLC to other state lotteries is like comparing apples to oranges.

In addition, even when an entity provides coupons for a particular product, e.g., a new lottery game, studies report that at least eight percent of redeemed coupons are misredemptions. In other words, customers often use coupons for other products.³⁵

According to a MSLC memo, one lottery agent caught in the Attorney General's sting operation said that, "he treated coupons like *lottery money*; i.e., he didn't always make his customers use the coupons for the proper ticket. If they didn't want Drive of a Lifetime, he gave them what he (sic) wanted."³⁶ In another disciplinary case, a lottery agent stated, "that people would ask for certain

³³ Magid M. Abraham and Leonard M. Lodish, "Getting the Most Out of Advertising and Promotion," *Harvard Business Review*, May-June 1990, p. 50.

³⁴ Treasurer Joseph Malone, Testimony to Government Regulations Committee, March 12, 1997.

³⁵ Erick Larson, *The Naked Consumer*, Henry Holt and Company: New York, 1992.

³⁶ MSLC, Memo on Rantoul Liquors, March 25, 1997.

scratch tickets no matter which coupon they had, and he would try to accommodate his customers."³⁷ Because the MSLC never tracked which lottery products coupons were being used for, the extent of the misredemption problem cannot be measured.

Coupons and the Bottom Line

When the MSLC announced that the agency planned to terminate the use of all coupons, including Val-Pak promotions, effective February 1997, the MSLC estimated that net revenue to the Local Aid Fund would decline by \$20 million.³⁸

This dire prediction has not proved accurate. While it is premature to make conclusions about the long-term impact of terminating the coupon program, the short-term impact has been anything but devastating. On October 19, 1997, the MSLC announced results for FY 1997 showing that the agency experienced its most profitable year ever: sales increased 5.4 percent to \$3.2 billion and profits grew at an even faster 8.7 percent rate to \$720 million. As a result, cities and towns received two additional local aid appropriations this year totaling \$45 million.³⁹

Sales increases only matter if profits grow because it is MSLC profits that generate local aid to Massachusetts cities and towns. The latest figures suggest that the marketing studies referenced earlier in this section may be correct in concluding that promotions like the lottery coupon program may actually reduce profits. Clearly this is a factor that should be considered prior to reintroduction of coupon programs in the future.

Summary

The MSLC distributed coupons in three primary ways: direct mail, coupons-for-advertising deals, and a give away program.

While MSLC personnel should be commended for improvements made in the coupon program during the 1990's, namely, bar codes on coupons, increased site security, and the switch away from free products to buy-one-get-one-free offers in Val-Pak mailings, the coupon program remained rife with problems. Hundreds of millions of lottery coupons were distributed, and MSLC personnel allowed the program to essentially become a printing press for lottery money. After the *Boston Globe* investigative series, Treasurer Joe Malone announced

³⁷ MSLC, Memo on Ramos Package Store, March 25, 1997.

³⁸ Treasurer Joseph Malone, Correspondence with Speaker of the House Thomas Finneran, February 13, 1997.

³⁹ *The Beacon*, Massachusetts Municipal Association, December 1997, p. 3.

the termination of all coupons, including the Val-Pak promotions, effective immediately.⁴⁰

Earlier this year, the *Boston Globe* reported that Samuel M. DePhillippo, the MSLC's Executive Director, said that he was struggling to curb the lottery's "go-go" culture.⁴¹ In the end, the coupon program epitomized that culture. If coupons are reintroduced at the MSLC, great care should be taken to create a system of controlled promotion and growth.

⁴⁰ Treasurer Joseph Malone, Correspondence with Speaker Thomas M. Finneran, February 13, 1997.

⁴¹ *Boston Globe*, February 9, 1997, p. A1.

The Statutory Advertising Cap

According to Charles T. Clotfelter and Philip J. Cook in *Selling Hope: State Lotteries in America*, lottery agencies often act more like a business than a conventional government agency, and nothing so vividly illustrates this as the marketing strategies that state lottery agencies employ to sell their products.⁴²

Marketing the lottery can be controversial. For example, the former Governor of California, George Deukmejian, was quoted as saying, "I don't think it's good for the state or good public policy to go out and push and urge people to gamble."⁴³

The MSLC has received similar criticism. In 1996, a legislator complained to Treasurer Joseph Malone about an in-store MSLC display titled, "How to Make Millions," which suggested that the way to get ahead in life was to play the lottery. The promotion was discontinued.⁴⁴ Jim O'Brien, the MSLC's Director of Marketing, once speculated that other state lotteries were slow to use direct mail because, as state agencies, they would be subject to criticism for soliciting business. O'Brien stated, "Direct mail is a controversial medium because it shows some aggressiveness when you give free bets."⁴⁵

The Mixed Message on Values

Clotfelter and Cook note in their book *Selling Hope: State Lotteries in America* that most states' citizens see lottery ads far more often than virtually any other message put out by state government. The authors state that, "At a more basic level the sales job may be viewed as an education in values, teaching that gambling is a benign or even virtuous activity that offers an escape from the dreariness of work and limited means."⁴⁶ Lottery advertising often endorses the dream of easy wealth: "The ads are unabashedly materialistic, and their message is a slightly subversive one - that success is just a matter of picking the right number."⁴⁷

⁴² Charles T. Clotfelter and Philip J. Cook, *Selling Hope: State Lotteries in America*, Harvard University Press: Cambridge, 1989, p. 186.

⁴³ *Ibid.* at 187.

⁴⁴ Treasurer Joseph Malone, Correspondence with Representative Peter J. Larkin, March 12, 1996.

⁴⁵ *Lottery World*, "Lottery Advertising in the Year 2000," undated. Newsletter provided by Val-Pak of Massachusetts.

⁴⁶ Charles T. Clotfelter and Philip J. Cook, *Selling Hope: State Lotteries in America*, Harvard University Press: Cambridge, 1989, p. 243.

⁴⁷ *Ibid.*

Because of the sometimes controversial nature of lottery promotion, states often try to contain advertising efforts. For example, Missouri, Virginia, and Wisconsin have laws on the books forbidding ads that "induce" people to play the lottery.

History of the Massachusetts Statutory Advertising Cap

In Massachusetts, the Legislature has grappled with the issue for several years and decided to statutorily cap the advertising budget and limit the scope of promotion available to the MSLC. Under the leadership of Senate President Thomas Birmingham, the advertising budget for the MSLC dropped from \$11.6 million in FY 1993, to \$3.6 million in FY 1994, to \$2.8 million in FY 1995, and has been capped at \$400,000 for the last three fiscal years. The advertising budget was also explicitly limited to point of sale promotions and agent newsletters beginning in FY 1996. Senate President Birmingham explained the rationale for the statutory advertising cap when he stated, "There is a fundamental difference in allowing gambling for the purpose of raising revenue and actually enticing people to play."⁴⁸

Through the implementation of the statutory advertising cap, the Legislature was attempting to strike a balance between critical revenue generation and over-aggressive promotion to residents.

⁴⁸ *Boston Globe*, July 6, 1993, p. 21.

The Sky is Falling

Over the past five years, as MSLC funding for advertising officially dropped from \$11.6 million to \$400,000, Treasurer Joseph Malone and MSLC personnel have repeatedly promised steep declines in MSLC revenue. So far, these dire predictions have been wrong.

1993: Treasurer Malone: "The Senate President is punishing cities and towns who depend on lottery revenue because of a personal vendetta against me." MSLC personnel predict that the cut will slash gross revenues by \$400 million and cost cities and towns \$120 million in local aid.⁴⁹

1995: Eric Turner, then-Executive Director of the MSLC: "The distinct possibility exists that no revenue growth will occur."⁵⁰

1997: Treasurer Malone: "We estimate that the termination of this practice (coupons) will result in an annual reduction of approximately \$20 million in net revenues from lottery operations."⁵¹

Since FY 1993, when the MSLC advertising budget was first trimmed, net revenue for the MSLC has soared. In FY 1992, the MSLC's net was less than \$500 million; in FY 1997, profits grew to \$720 million. In fact, during FY 1997, profits grew 8.7 percent from the previous year.

Circumvention of the Statutory Advertising Cap

The Massachusetts Legislature has clear authority to appropriate funds for state agencies. M.G.L. c.29, §1 defines an appropriation as, "the authorization by the general court with the approval of the governor, or by overriding his objection thereto, of the expenditure of state revenues for a specified purpose up to a maximum amount for a specified period of time." The Legislature has the exclusive authority to determine the purposes for which the expenditure of funds is made available, and it may also attach conditions to items in an appropriation measure, prescribing the exact purposes for which the money may be spent. See, Opinion of the Justices, 375 Mass 827, (1978).

⁴⁹ *Boston Globe*, July 6, 1993, p. 21.

⁵⁰ *Boston Globe*, June 21, 1995, p. 22.

⁵¹ Treasurer Joseph Malone, Correspondence with Speaker Thomas M. Finneran, February 13, 1997.

In addition, M.G.L. c.29, §26 states that "the expenses of the offices and departments... shall not exceed the appropriations made therefor by the general court or the allotments made therefor by the governor." Section 27 further states that, "no department, office, commission or institution shall incur an expense... unless an appropriation by the general court and allotment by the governor, sufficient to cover the expense thereof, shall have been made. Appropriations by the general court, and any allotments by the governor, shall be expended only in the amounts in subsidiary accounts." M.G.L. c.29, §§26-27.

The Legislature has been exceedingly clear in its directive to contain the advertising and promotional expenses of the MSLC. The MSLC spent \$11.6 million in FY 1993, before the Legislature created a separate line item for advertising and placed a cap of \$3.6 million on these expenditures in FY 1994. After legislative leaders learned that advertising costs were being shifted to other parts of the MSLC budget, the Legislature's directive to the MSLC became even more stringent. A separate line item was established for lottery advertising with clear limits on what type of promotion was acceptable and prohibiting the expenditure of any other funds for promotional purposes. A comparison of language from the budgets since the advertising cap became an issue reflects the nature of the mandate.

Advertising Budget History

Fiscal Year	Line Item	Appropriation	Language
FY 1993	0640-0000	\$67,767,987	For the expenses of the operation and administration of the state lottery. (No separate line-item for advertising.)
FY 1994	0640-0010	\$3,600,000	For the purpose of advertising associated with the state lottery program;...provided further, that funds made available herein shall be the only funds made available for advertising lottery games; and, provided further, that no non-appropriated funds shall be expended for the purposes of advertising lottery games.
FY 1995	0640-0010	\$2,800,000	For the purpose of advertising associated with the state lottery program;...provided further, that the funds made available herein shall be the only funds made available for advertising lottery games; and provided further, that no non-appropriated funds shall be expended for the purposes of advertising lottery games.
FY 1996 FY 1997 FY 1998	0640-0010	\$400,000	For the promotional activities associated with the state lottery program; provided, that said promotional expenses shall be limited to point of sale promotions and agent newsletters.

A Clear Limit on Advertising

Like the line item for advertising, the MSLC general appropriation language has also been clear and specific about restrictions on advertising.

- FY 1995 and 1996 -- "Provided further that no funds shall be expended from this item for any costs associated with advertising lottery games."
- FY 1997 -- "Provided further that no funds shall be expended from this line item for any costs associated with the promotion or advertising of lottery games."⁵²

The legal mandate is clear: lottery advertising should be limited to \$400,000 annually and to point of sale promotions and agent newsletters. The MSLC flagrantly circumvented the law.

The circumvention of the increasingly strict advertising cap began with a shifting of expenses and budgetary sleight of hand. When the advertising cap endangered the Val-Pak program, coupons-for-advertising deals were struck, such as one with Raynham Taunton Greyhound Park, which was enticed with lottery coupons to pay for the cost of distributing the MSLC brochures through Val-Pak. When the MSLC assigned the cost of producing the Val-Pak coupons to the line item for printing instant tickets and stationery, Senate President Birmingham described these maneuvers as a "shell game."⁵³

Coupons-for-advertising deals were explicitly expanded to evade the statutory advertising cap. The earlier examples of correspondence between the MSLC and media outlets make it clear that there was an outright *quid pro quo*.

⁵² Auditor of the Commonwealth, *State Auditor's Report on Certain Activities of the Massachusetts State Lottery Commission*, May 22, 1997.

⁵³ *Boston Globe*, February 10, 1997, p. A1.

Bonus Advertising with Bonus Bonanza

On February 4, 1995, the MSLC created a program called Bonus Bonanza, a lottery game show in conjunction with Jonathan Goodson Productions. The game show was designed to highlight on-line games such as Megabucks and Mass Millions and featured several games of chance. Participants and viewers were able to win large cash prizes.

Despite the inclusion of even stricter budgetary language restricting advertising and promotion, the MSLC continued to spend large sums on Bonus Bonanza.⁵⁴ In FY 1996, when the MSLC's general appropriation stated, "no funds shall be expended from this item for any cost associated with advertising lottery games," MSLC budget figures show direct expenditures for Bonus Bonanza of more than \$1.6 million.⁵⁵

Production costs were minor in comparison to the promotional costs shifted to the prize budget. Internal memos indicate that MSLC personnel estimated total weekly prize costs to participants and viewers of \$179,349. Bonus Bonanza ran 52 weeks a year.⁵⁶ Consequently, extrapolated annual prize costs associated with the game show exceeded \$9.3 million. Another internal MSLC document indicates that the MSLC annually distributed 75,000 coupons for a "Bonus Bonanza Coupon Program."⁵⁷ In short, promotional costs to the MSLC as part of Bonus Bonanza easily exceeded \$10 million annually, despite the clear statutory mandate to cap advertising and promotional expenses.

In October 1997, the MSLC announced the cancellation of Bonus Bonanza. Sam DePhillippo, Executive Director of the MSLC, was quoted in *La Fleur's Lottery World* as saying, "Frankly, we're satisfied with controlled growth. Over the last couple of years, we've experienced modest sales growth, but extremely healthy profit growth. We're not sure if this TV show has had any impact upon sales."⁵⁸

⁵⁴ Bonus Bonanza began in early 1995, before the stricter language of the MSLC's general appropriation became part of the FY 1996 budget.

⁵⁵ MSLC, FY96/97 Project Spending Memo, undated.

⁵⁶ MSLC, Memo from Jim O'Brien, Director of Marketing, to Eric Turner, Executive Director, January 5, 1995.

⁵⁷ MSLC, Lottery Promotion Programs, FY 1996, undated.

⁵⁸ *La Fleur's Lottery World*, Volume 5, No. 3, November 1997, p. 8.

Abuse of the Coupon Program

The Attorney General's sting operation in 1996 brought to light the issue of outright fraud among certain lottery agents in Massachusetts. The Attorney General's office, led by Assistant Attorney General Elisabeth Ditomassi, indicted eleven lottery agents or their employees for defrauding the Commonwealth. Most of the individuals and businesses indicted pled guilty to charges of larceny and filing a false claim.

As a result of the Attorney General's actions, the MSLC began to more aggressively investigate coupon abuse by lottery agents. Since December 1996, the MSLC has either suspended or revoked the licenses of at least nine lottery agents as a result of suspicious or criminal use of coupons. The MSLC also cooperated with the Attorney General's investigation by, for example, printing a special batch of coupons with a marker that would be useful to a sting operation.

While there has been progress made in some key policy areas, until 1996 the MSLC had failed to create an aggressive enforcement program targeting abuse and fraud by lottery agents. It was only after the Attorney General took action that the MSLC revoked or suspended the licenses of some lottery agents.

A review of the facts from the completed case files of the Attorney General's investigation and recent MSLC suspension hearings illustrate how easy it was for lottery agents to misuse coupons and defraud the Commonwealth. Moreover, the MSLC's own policies allowed lottery agents to treat coupons like "lottery money." For example, large batches of coupons were given to organizations, businesses, and individuals to redeem; MSLC field agents used coupons to settle accounts; and agent enforcement regarding coupons was negligible.

Red Flags Flapping, No One Watching

Until Assistant Attorney General Ditomassi asked for a list of lottery locations which redeemed the largest percentage of coupons, the MSLC had never used such a list to actively identify coupon abuse.⁵⁹ When the list was produced, the percentage of coupon redemptions at some locations was remarkable.

The average coupon redemption rate for lottery agents is 1.5 percent of sales, according to MSLC documents. The agent with the highest redemption rate, Bao Viet, a convenience store in Chelsea, had a coupon to sales ratio of 32 *percent*. All of the top twelve lottery coupon cashing agents had coupon to sales ratios over ten times the average.⁶⁰ Despite these red flags, the MSLC never used its bar coding ability to identify suspicious patterns prior to the Attorney General's investigation.

When bar coding was first initiated, it was a major advance; indeed, the MSLC became the first state lottery to have a sophisticated way to track when and where coupons were redeemed. The promise was palpable. A memo from Jim O'Brien, the Director of Marketing for the MSLC, stated, "Each of our intelligent coupons is unique and can only be cashed once. Any subsequent attempt to cash a previously cashed coupon will not be accepted by the system. Obviously this eliminates, for all intents and purposes, the possibility of coupon fraud... Coupon fraud is eliminated, removing any potential for revenue losses and credibility problems."⁶¹ The new system apparently lulled the MSLC into believing that the agency did not have to aggressively monitor fraud at the level of lottery agents. The Attorney General's sting operation disproved that naïve assumption.

⁵⁹ MSLC, Memo from John P. Kelly, Manager of Security, to File, Coupons: Chronological Sequence of Events, March 31, 1997.

⁶⁰ MSLC, Coupons to Sales Ratio Print Out, undated.

⁶¹ MSLC, Memo from Jim O'Brien, Director of Marketing, to Staff, On-Line Cashing of Coupons, August 15, 1991.

Black Market Coupons Feed Fraud

As a result of the Attorney General's investigation, the weak link in the coupon program emerged. It was possible to redeem a coupon for its cash value without also purchasing a lottery ticket, and the MSLC never actively investigated discrepancies between coupon redemption rates and actual lottery ticket sales until the Attorney General became involved.⁶²

Since black market coupons could be purchased for a fraction of their value, both lottery agents and their employees had the opportunity to cheat. Lottery agents could process the Val-Pak lottery coupons without a parallel lottery ticket purchase. In one example, a Worcester company, Tatnuck Square Getty, was found guilty of larceny and presenting a false claim after the owner paid an undercover state trooper \$15,000 for 10,000 Val-Pak brochures containing coupons valued at \$90,000. The company's owner committed larceny by submitting a false claim for coupon redemption without having sold a lottery ticket. Tatnuck Square Getty had a coupon redemption to lottery ticket sales ratio of 29.2 percent, far higher than the average redemption ratio.⁶³

Tellingly, the defense attorney representing the lottery agent argued in his closing statement that, "What happened here is that a loophole in this whole process (lottery coupon processing) was found and the lottery said, 'we don't like it.'" The lawyer also noted that lottery sales representatives sometimes reconciled accounts with sales agents by paying them off with coupons.

In another example, an employee of Bay State Liquor Mart in Pocasset pled guilty to two charges of larceny and one charge of filing a false claim. The employee purchased bulk lottery coupons from an undercover state trooper and when customers paid cash for lottery coupons, the employee redeemed the coupons and pocketed the difference.

One source for black market coupons was postal theft. In one documented example, a postal employee was caught stealing Val-Pak coupons. He agreed to cooperate with law enforcement officials and subsequently implicated several lottery agents who willingly paid below face value for coupons in bulk. The postal employee had access to the Val-Pak Coupons at the Chicopee Post Office, where undeliverable Val-Pak mailings were sent to be discarded.

Not only did the MSLC fail to put in place an effective enforcement effort directed

⁶² MSLC, Memo from John P. Kelly, Manager of Security, to File, Coupons: Chronological Sequence of Events, March 31, 1997.

⁶³ Commonwealth v. Nassif, No., 96-0677 (D. Mass. Filed May 29, 1997).

at lottery agents, it also helped create a culture where abuse could thrive. Val-Pak brochures were supposedly limited to one per person, in order to avoid the kind of abuse uncovered by the Attorney General. However, promotions constantly provided dozens, hundreds, or even thousands of coupons to individuals who won them. Consequently, lottery agents saw individuals cash coupons in bulk, which made transactions in bulk coupons appear normal. In another example, the MSLC used coupons as a substitute currency that provided an easy, painless way to settle accounts with lottery agents, so agents grew accustomed to processing dozens or hundreds of bulk coupons for MSLC reimbursement.

Other States' Experiences with Lottery Coupons

According to the MSLC, 32 out of 39 state lotteries use coupons as a promotional device.⁶⁴ However, the *Boston Globe* reported that Massachusetts' reliance on coupons as a substitute currency is unique among state lotteries: David Gale, Executive Director of the North American Association of State and Provincial Lotteries, stated, "couponing is standard, but the degree to which Massachusetts uses it is very unusual."⁶⁵

The Bureau surveyed other state lotteries to understand how they use coupons and whether Massachusetts can learn to better design or implement coupon programs from some of the best practices in other states. A total of 36 state lotteries responded to the survey.

The survey results bear out Mr. Gale's assertion that couponing is standard, and that Massachusetts is unique in the sheer magnitude of its coupon programs. While Massachusetts distributed hundreds of millions of lottery coupons, other comparable state lotteries either distributed a small fraction of that amount or none at all.

Comparing Massachusetts with State Lottery Peers

Excluding Massachusetts, the following states make up the top four state lotteries in terms of gross sales. These states appear in descending order:

- **New York** New York Lottery Games has a variety of coupons with different offers and different delivery systems, including targeted direct mail coupons, promotional coupons that are distributed either through joint promotions or at select fairs or public events, and specifically designed promotional coupons for agent on-site promotions on specific dates. One memo from the New York State Lottery indicates that the agency distributed less than four million lottery coupons during FY 1996.⁶⁶
- **Texas** The Texas State Lottery uses a carefully calibrated direct mail campaign carried out with EQUIFAX National Decisions Systems which identifies households that may have a propensity to play lottery games. Over the past several years, the Texas Lottery has done targeted mailings of less than three million single buy-one-get-one-free lottery coupons.⁶⁷

⁶⁴ MSLC, Testimony to Joint Committee on Government Regulations, March 12, 1997.

⁶⁵ *Boston Globe*, February 10, 1997, p. A1.

⁶⁶ New York Lottery Games, Memo from Matt Mansfield, Director of Advertising, to Connie Laverty, Lottery Director of Marketing and Sales, FY 96/97 Direct Mail Coupon Program, December 3, 1996.

⁶⁷ Texas Lottery, Correspondence from Toni Smith, Instant Product Manager, to Massachusetts Senate Post Audit and Oversight Bureau, July 24, 1997.

- **Ohio** Like Texas, the Ohio Lottery uses information from EQUIFAX National Decisions Systems to create player profiles to identify potential lottery players, with the goal of increasing the instant ticket player base. The program identified individuals who fit the potential player profile and lived within a zip code that, on average, played fewer instant games than other neighborhoods.⁶⁸
- **California** Coupon programs have been limited to four promotions since 1993, such as mailing out 1 million direct mail coupons to introduce Keno in 1994.

California: Best Practices from the Opposite Coast

While the California State Lottery has operated limited coupon programs, it has chosen to do so accountably. The Director uses his authority under the Lottery Act to create coupon programs, but there are general Reserve Prize Fund Regulations and every specific promotion has its own official rules. Unlike the MSLC, which runs its promotions on a seemingly ad hoc basis, the California State Lottery clearly spells out the purpose and terms of every promotion, retailer responsibilities, and mandates a public winners list.

In addition, the California State Lottery has made it a practice to review and analyze the results of every promotion in order to gauge the cost-effectiveness of the activity. In correspondence with the Senate Post Audit and Oversight Bureau, Ken Giebel, the Promotions Manager, describes the results:

"The results of these programs have been spotty and have not generated a significant increase in sales."⁶⁹

In addition to the highest grossing lotteries, the Georgia Lottery is also a peer of the MSLC because it is second only to Massachusetts in per capita expenditures on lottery tickets. The Georgia Lottery does not operate any sort of coupon program.⁷⁰

⁶⁸ Ohio Lottery, Correspondence from Sheila Smith, Instant Ticket Product Manager, to Massachusetts Senate Post Audit and Oversight Bureau, July 2, 1997.

⁶⁹ California Lottery, Correspondence from Ken Giebel, Promotions Manager, to Senate Post Audit and Oversight Bureau, July 15, 1997. See Appendix A for California's Reserve Prize Fund Regulations.

⁷⁰ Conversation with Loren Shyla, Georgia Lottery, summer 1997.

Local Aid and Past Due Accounts

In addition to conducting a review of coupon programs, the Bureau focused on Local Aid disbursement to Massachusetts cities and towns.

Local Aid to Massachusetts Cities and Towns

The State Lottery Law explicitly states that the purpose of the lottery is to generate revenue for the state, in particular to provide property tax relief through the Local Aid Fund.

Given this mission, it is worthwhile to highlight a finding made by the State Auditor's report in May 1997, which outlined a serious problem with "inadequate collection of lottery receipts from sales agents."⁷¹

According to that report, more than \$13.2 million in cash sales receipts was owed to the MSLC from 1,106 sales agents as of June 30, 1996. This overdue balance represented a 191% increase over the comparable balance the previous year. Moreover, more than \$10 million of this balance was more than 90 days overdue.

MSLC personnel point out that much of the increase from 1995 to 1996 resulted from a new system of automatic settlement implemented by the MSLC in the spring of 1996, which resulted in much quicker recognition of instant ticket revenue. Automatic settlement allows the agency to improve the accounting practices at lottery agent locations: the computer determines which instant ticket books are eligible for settling and automatically tabulates all prizes, bonuses, and commissions on a bi-weekly basis.⁷² Automatic settlement is clearly an improvement over the manual settlement procedures that it replaced. The State Auditor's report indicated that the MSLC recently hired three new employees in their collections department to improve collection practices. While these actions have been taken to correct this problem, more can be done.

Issues with Local Aid and Past Due Accounts

1. The State Auditor's report clearly showed that too many lottery agents are slow to pay their debts to the MSLC. The MSLC retains the right to shut off lottery machines at a sales agent location that is past due on its debts, but

⁷¹ Auditor of the Commonwealth, *Report on Certain Activities of the Massachusetts State Lottery Commission*, May 22, 1997, pp. 41-45.

⁷² MSLC, Correspondence to Sales Agents, undated.

MSLC administrators have expressed a reluctance to shut off the machines. Massachusetts should explore additional sanctions to ensure that collections are timely and that this important stream of public revenue is not hindered, such as a proposal to make lottery agents with past due balances over 30 days old ineligible to redeem prize bonuses if a winning ticket is bought at their location.

2. Currently, there are no municipal officials on the MSLC. Given its mission to provide property tax relief to cities and towns, it would appear that Massachusetts municipalities are inadequately represented on the Commission.

Gambling Addiction and Lottery Promotion

One of the critical issues related to MSLC promotion is its impact on addicted gamblers in Massachusetts. A new study released by the Harvard Medical School Division on Addictions provided some sobering news about gambling addiction.⁷³

- As gambling through lotteries, casinos and games like charitable bingos has expanded over the past two decades, gambling disorders have increased.
- Gambling disorders are significantly more prevalent among young people than the general population.
- Scientists and public policy makers have paid insufficient attention to gamblers with undiagnosed gambling disorders, who are much more common than diagnosed cases of acute gambling disorders. In the most recent period, undiagnosed gambling disorders are estimated to affect almost 2.8 percent of the general population and 14.8 percent of adolescents.

The Massachusetts Council on Compulsive Gambling estimates that 4.4 percent of Massachusetts residents, or approximately 200,000 adults, are dealing with compulsive or problem gambling addictions.⁷⁴ Beyond this immediate population, there is also a larger societal cost to families and communities created by gambling addiction.

Thomas N. Cummings, Executive Director of the Massachusetts Council on Compulsive Gambling, stated that in his opinion the Council now receives more calls from gamblers in trouble because of scratch tickets and KENO than sports bets, unlike previous years.⁷⁵ Clearly, Massachusetts policy makers should be concerned about the impact of lottery advertising and promotion on this vulnerable population.

⁷³ Howard Shaffer, Matthew N. Hall, and Joni Vander-Bilt, Harvard Medical School Division on Addictions, *Estimating the Prevalence of Disordered Gambling Behavior in the United States and Canada: A Meta-analysis*, December 2, 1997.

⁷⁴ Massachusetts Council on Compulsive Gambling, Correspondence from Thomas N. Cummings to Senate Post Audit and Oversight Bureau, November 25, 1997.

⁷⁵ Massachusetts Council on Compulsive Gambling, Thomas N. Cummings, Executive Director, Fax to Senate Post Audit and Oversight Bureau, December 8, 1997.

The Potential Harm to Addicted Gamblers

Dr. Howard Shaffer, the Director of the Division on Addictions at Harvard Medical School, stressed that there is little scientific research available on household gambling promotions such as Val-Pak coupons, but that clinical evidence and anecdotal reports should lead us to be careful with coupon promotions: "like many other messages that describe gambling, Val-Pak coupons have the capacity to trigger relapses to disordered gambling among those intemperate lottery players who are trying to stop. This is particularly true when people discover the coupons unexpectedly...I would discourage the distribution of Val-Pak coupons through the general mail since this represents a difficult to regulate activity."⁷⁶

Mr. Cummings also urges caution regarding the reintroduction of coupon promotions: "We cannot state conclusively that new cases of compulsive or problem gambling will occur because individuals receive a lottery coupon. Our concern is that the State recognize that the potential risk is there, and should not be ignored. We would urge the Oversight Committee to consider the question of how might the Commonwealth reduce the risk?"⁷⁷

Issues Regarding Impact of Lottery Promotion on Addicted Gamblers

1. Although Massachusetts has operated a state lottery for 25 years, there is little current research regarding gambling addiction associated with the lottery, according to gambling addiction experts. In addition, there is negligible scientific research about the effect of lottery promotions such as direct mail lottery coupons on addicted gamblers.
2. The state has historically under-funded its efforts to deal with the estimated 200,000 compulsive and problem gamblers in Massachusetts. In FY 1996, for example, the state budget only allotted \$450,000 for outreach and treatment of compulsive gamblers.
3. Although the MSLC has sent out literally hundreds of millions of direct mail coupons over the past decade, none of the Val-Pak or Souper Coups brochures have used the direct mail opportunity to provide information about assistance with compulsive or problem gambling.

⁷⁶ Division of Addiction, Harvard Medical School, Dr. Howard J. Shaffer, Director, Correspondence to Senate Post Audit and Oversight Bureau, December 1, 1997.

⁷⁷ Massachusetts Council on Compulsive Gambling, Thomas N. Cummings, Executive Director, Correspondence with Senate Post Audit and Oversight Committee, November 25, 1997.

Findings and Recommendations

A. Circumvention of the Statutory Advertising Cap

Finding: Through a massive lottery coupon program and explicit trading of lottery coupons for advertising, the MSLC intentionally and flagrantly circumvented the law.

Recommendation: The MSLC must abide by both the letter and spirit of the law and should seek specific legislative authorization for any program that exceeds statutory limits on the scope or costs of lottery promotion.

B. Issues of Fairness

Finding: Massachusetts residents did not have equal access to lottery coupons. Some towns never received Val-Pak bulk mailings, and coupon distribution through coupons-for-advertising deals was uneven across regions. Additionally, organizations received coupons through a give away program that few outsiders knew existed.

Recommendation: If a coupon program is reintroduced, the program must be structured in a way that will provide all Massachusetts residents, businesses, or non-profit organizations equal access to this taxpayer resource.

Finding: Under an unofficial give away program, the MSLC provided contributions of free-play coupons and free season tickets to organizations. The MSLC did not notify all Massachusetts nonprofit organizations that such a give away program existed, and there were no clear rules regarding eligibility.

Recommendation: If the MSLC reintroduces a give away program, the process should be open to all non-profit groups: public notice, fair and public rules for distribution, and a serious attempt to ensure that the coupons or lottery products are actually used for their intended purpose should be standard practice.

C. Issues of Accountability

Finding: The MSLC never promulgated regulations regarding how coupons were to be printed, distributed, or used. Consequently, the coupon program was administered in an arbitrary manner with little accountability.

Recommendation: If the Legislature authorizes a new coupon program, rules and regulations under which the program would operate must be promulgated. Following the model in California, the MSLC should have a general regulation for coupon programs and also create individual regulations for each coupon promotion. These regulations should, for example, require the MSLC to spell out the purpose of the promotion and retailer responsibilities, as well as mandate such things as a public winners list.

Finding: Because there were no clear rules for the coupon program, the selection of businesses for coupons-for-advertising deals was haphazard. Some businesses received preferential treatment and received significantly more coupons than other similar entities. In almost every case, no competitive bidding was required to participate in the program, and no signed contracts existed even though public resources worth millions of dollars were traded.

Recommendation: Coupons-for-advertising deals must be treated like other public resources. The program must have public notice, competitive bidding, and signed contracts as standard operating procedure.

Finding: The MSLC did not track prizes collected by customers who used coupons to purchase lottery tickets, making it impossible to know the true cost of the promotion.

Recommendation: There must be strict accountability regarding the true costs of coupon promotions. The MSLC must be able to report the prizes won by customers with coupons, so that the agency can make a careful calculation of actual promotional costs.

Finding: The MSLC did not adequately protect the coupon program from misuse and abuse. In an investigation of MSLC lottery agents during 1996 and 1997, the Attorney General's office uncovered serious criminal violations. As a result of the investigation, several lottery agents have been convicted of defrauding the Commonwealth. There is a clear pattern of lax enforcement.

Recommendation: Security and enforcement procedures for coupons must be stronger. After every coupon promotion, security personnel should review redemption statistics for possible abuses. It should be impossible to redeem a lottery coupon without purchasing a corresponding lottery ticket. Documentation that coupons were used in the ways intended must be maintained and available for review. Moreover, the MSLC should operate an aggressive enforcement program aimed at policing fraud by lottery agents.

Finally, the MSLC must investigate possible misuse and abuse of lottery coupons by agency employees.

Finding: Despite giving away hundreds of millions of coupons, the MSLC did not thoroughly evaluate the effectiveness of the promotion. Among the thousands of documents reviewed by Bureau staff members, none indicated that the MSLC has ever evaluated the coupon program to see whether it works to effectively promote new or existing lottery games.

Recommendation: The MSLC should undertake a thorough evaluation of the effectiveness of any coupon program if it is reintroduced. Coupons are only worthwhile if the program effectively promotes new or existing lottery games. The MSLC should follow the model of the California Lottery and evaluate each coupon promotion for effectiveness.

D. Local Aid and Past Due Accounts

Finding: Due to inadequate sanctions, lottery agents are sometimes slow to pay their debts to the MSLC. The State Auditor found that lottery agents owed the MSLC more than \$13 million in June 1996, with more than \$10 million of that amount more than 90 days past due.

Recommendation: The MSLC should explore additional sanctions to ensure that collections are timely and that this important source of public revenue is not hindered. One proposal may be to preclude a lottery agent from receiving his or her bonus if a winning lottery ticket is sold at their location and they have debts to the MSLC more than 30 days old.

Finding: The purpose of the MSLC is to generate revenue for the state, in particular to provide property tax relief to cities and towns through the Local Aid Fund. Given its mission, it would appear that Massachusetts cities and towns are inadequately represented on the Commission.

Recommendation: To emphasize the centrality of cities and towns to the mission of the MSLC, the Commission should be expanded to include two new members to represent the Massachusetts Municipal Association.

E. Gambling Addiction and Lottery Promotion

Finding: The state has never thoroughly researched the issue of compulsive and problem gambling created by the state lottery, and the MSLC has not adequately investigated the potentially negative impact of its advertising and promotion on vulnerable individuals.

Recommendation: A broad review of gambling addiction associated with the Massachusetts State Lottery, including an analysis of the impact of promotion and advertising on compulsive and problem gamblers, should be commissioned.

Finding: Until the current fiscal year, the state had not committed adequate resources for outreach and treatment of compulsive and problem gambling.

Recommendation: At a minimum, the current FY 1998 level of funding for the Massachusetts Council on Compulsive Gambling should be maintained.

Finding: Promotions such as direct mail coupon brochures have the potential to trigger a relapse for people struggling with gambling addictions. In the past, little was done to mitigate the potential damage done by direct mail promotions to this vulnerable population.

Recommendation: If direct mail coupons are reintroduced, brochures should prominently include an informational panel on the Massachusetts Council on Compulsive Gambling, including its toll-free telephone number.

Conclusion

In conclusion, this report is neutral regarding whether a lottery coupon program should exist in the future. However, any new lottery coupon program must adhere to the following basic conditions:

1. Specific authorization by the Legislature
2. Fair distribution to residents, businesses, and organizations
3. Administration under an open process with written regulations
4. On-going evaluation of the effectiveness of the program
5. Accountability to the public and paying lottery customers
6. Sensitivity to the estimated 200,000 addicted gamblers in Massachusetts

By administering this \$100-million-a-year lottery coupon program in a loosely-regulated and unaccountable manner, the MSLC gambled with the public trust. As the Legislature considers the reintroduction of a lottery coupon program, policy makers must learn from these past mistakes.

Appendix A

CALIFORNIA STATE LOTTERY
CALIFORNIA RESERVE PRIZE FUND REGULATIONS
(Commission Approved March 16, 1994)

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CALIFORNIA STATE LOTTERY
RESERVE PRIZE FUND REGULATIONS

1. PURPOSE

The California State Lottery (CSL) may conduct and offer promotions to the public in conjunction with individual lottery games using reserve prize funds. The promotions shall be subject to these regulations, the applicable lottery game regulations, and the specific reserve prize fund promotion rules approved by the Director. The promotions shall be conducted as a means for increasing sales and distributing prize funds as required by law.

2. RETAILER PARTICIPATION

- a. Only the CSL, acting as a retailer, or retailers who have contracted with the CSL are authorized to participate in the promotions conducted pursuant to these regulations.
- b. CSL retailers shall comply with these regulations, the promotion rules, the CSL Act, the CSL's Retailer Regulations, the Retailer Contract, and any regulations, directives, procedures, and/or instructions of the CSL or the Director pertaining to the reserve prize fund promotions.

3. RETAILER COMPENSATION AND INCENTIVE BONUS

- a. The Retailer Compensation and Incentive Bonus Regulations shall control the compensation and incentive bonus, if any, paid to participating retailers.
- b. Retailer compensation, if any, specific to the promotion shall be stated in the reserve prize fund promotion rules.

4. RESERVE PRIZE FUND PROMOTIONS

- a. The Director or designee may distribute tickets, cash or merchandise pursuant to reserve prize fund promotions conducted in accordance with these regulations.
- b. For purposes of these California Reserve Prize Fund Regulations, "promotion" is defined as an "added value" offer to players sanctioned by the Commission or the Director. In each case, the promotional ticket or merchandise must be linked to lottery ticket purchase(s) by a player. Reserve Prize Funds may not be used in give-aways where there is no related

lottery ticket purchase by the recipient of the promotional ticket or merchandise.

- c. The Director or designee shall promulgate reserve prize fund promotion rules specific to each promotion conducted pursuant to these regulations.
- d. At a minimum, the reserve prize fund promotion rules shall provide the following:
 - (1) Purpose of the promotion;
 - (2) Identify the lottery game for the promotion;
 - (3) Instructions on how to play or participate in the promotion;
 - (4) Eligibility requirements;
 - (5) Participation or entry requirements;
 - (6) Alternate method of participation or entry, if any;
 - (7) Prizes and odds, if applicable;
 - (8) Date of drawing(s), if any;
 - (9) Term of promotion;
 - (10) Disclosure statements, if applicable;
 - (11) Retailer responsibilities and compensation specific to the promotion, if any;
 - (12) Notification of participants or winners, if applicable;
 - (13) How to obtain a copy of the winner's list, if applicable;
 - (14) A statement, if applicable, that promotion participants agree to participate in publicity and the CSL's use of their name and/or likeness for advertising and publicity purposes without compensation; and
 - (15) Additional information necessary and pertinent to the promotion.

5. AUGMENTATION

The Director or designee, at his/her exclusive discretion, is authorized to augment on-line game prize funds from time-to-time with reserve prize funds.

6. MERCHANDISE PRIZES

- a. If merchandise prizes are distributed or disseminated pursuant to these regulations, as prizes, they shall not be exchanged for prize money.
- b. Undistributed merchandise prizes purchased with reserve prize funds as prizes for a specific promotion shall be used, if possible, as prizes in a subsequent promotion. If the CSL is unable to use undistributed merchandise prizes in a subsequent promotion, the CSL shall use its best efforts to sell, return, or auction the merchandise. Funds received from the sale or auction of such merchandise shall be returned to the reserve prize fund.

7. DRAWINGS

- a. Drawings, if any, conducted as a feature of a promotion shall be conducted by CSL staff designated by the Director or designee and pursuant to established procedures.
- b. All draw procedures for draws conducted by the CSL's Draw Management Section shall remain confidential to ensure the security, integrity, and fairness of the drawing.

8. PARTICIPATION RESTRICTIONS

The following individuals shall not participate in or receive any prize relating to any promotion conducted pursuant to these regulations: members of the Commission; any officer or employee of the CSL; and officer or employee of the Office of the State Controller who is designated in writing by the Controller as having possible access to confidential CSL information, programs, or systems; any contractor or subcontractor excluded by the terms of their contract from playing lottery games; or any spouse, child, brother, sister, or parent of the previously mentioned individuals who reside within the same household of the individual.

9. DISPUTES

The Director, at his/her exclusive determination, shall issue a final decision concerning any and all disputes which may arise between a promotion participant and the CSL; such determination shall be final.

10. GOVERNING LAW

In participating in the promotion, the participant agrees to comply with and to abide by the promotion rules, these regulations, California law, all applicable regulations and final decisions of the CSL, and all procedures and instructions established by the CSL Commission, the Director, or designee for the conduct of the promotion.

11. END OF PROMOTION OR GAME

The Director, at any time, may announce the end of promotion date or end of game date for an individual promotion or game. If a promotion is conducted in conjunction with a particular game that has ended, no tickets shall be sold and no free tickets shall be issued past the end-of-game date.

(Approved by the California State Lottery Commission on August 13, 1992; amended March 16, 1994)

